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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 451

WILLIAM WHITLOCK BRUSH, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 14–17) is not reported. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 44) is reported in 85 F. (2d) 32.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 20, 1936. (R. 50.) The petition for a writ of certiorari was filed October 9, 1936, and was granted November 16, 1936. (R. 52.) The jurisdiction of this Court is invoked under

Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the salary received by the petitioner as chief engineer of the Bureau of Water Supply of the City of New York constitutes income taxable by the United States Government.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, * * *.

Treasury Regulations 74:

> ART. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The

commissions of receivers appointed by State courts are subject to tax for 1928 and subsequent taxable years.

* * * * * *

STATEMENT

The material facts, as found by the Board of Tax Appeals (R. 14–17), are as follows:

The petitioner during the calendar year 1931 was employed as chief engineer of the Bureau of Water Supply of the City of New York. He has been so employed for thirty-six years. This is a statutory office. His duties as chief engineer include the protection of the water supply of New York City from pollution, the determination of the amount of water to be withdrawn from various sources, the operation of the municipal water system, supervision of personnel, all matters connected with the expenditure of moneys allocated for water supply purposes, and the preparation of plans, surveys, and reports on improvements and installations of the water supply system. (R. 14–15.)

In the early days of New York City, water was furnished its citizens by private companies. In certain areas, water is furnished and sold by private companies at the present time. The present water supply system of New York has been built up through the years by the construction of facilities by the city and the acquisition from time to time of private companies supplying certain areas. (R. 15.)

Water furnished by the city for business use is metered and the amount used is charged at a fixed rate. Water for private use is furnished on a flat annual sum basis, which is determined in accordance with the conditions that exist with respect to the particular residence served. Approximately 75% of the cost of maintaining and operating the water system of New York City is attributable to the furnishing of water for business and private use; approximately 25% is attributable to fire protection, street sprinkling and flushing, sewer flushing, supervision of private companies, and the supplying of water to communities outside of New York City. (R. 15.)

The municipal water system of New York City has entailed an enormous expense. The cost of the facilities for bringing water from the Catskills involved an expenditure of more than two hundred million dollars. A plan for additional water supply now under consideration contemplates an expenditure of two hundred and twenty-five million dollars. The sources of water supply of the several private companies now serving some of the outlying sections of the city are nearing a condition of exhaustion. (R. 15–16.)

The Board of Tax Appeals concluded (R. 17) that the salary received by the petitioner as chief engineer of the Bureau of Water Supply of the City of New York was taxable income. The Circuit Court of Appeals affirmed the decision of the Board. (R. 50.)

SUMMARY OF ARGUMENT

There is no statutory provision exempting the petitioner's salary as chief engineer of the Bureau of Water Supply of the City of New York from Federal taxation. The only possible basis for the exemption of the petitioner's salary from tax is the well established principle that agencies and instrumentalities employed by the state governments in the exercise of governmental functions essential to their independence are immune from taxation by the Federal Government.

The Bureau of Water Supply is not operated by the City of New York in the performance of an essential governmental function. The undertaking, while of admittedly great magnitude and for a public purpose, is inherently and traditionally of a proprietary and not a governmental nature, and does not come within the implied immunity from taxation by the Federal Government of the agencies of a State, or its political subdivisions. It follows that the petitioner's salary is subject to Federal income tax.

ARGUMENT

THE PETITIONER DID NOT RENDER SERVICES IN CONNECTION WITH AN ESSENTIAL GOVERNMENTAL FUNCTION OF THE STATE OF NEW YORK, AND HIS SALARY IS NOT EXEMPT FROM FEDERAL INCOME TAX

The case at bar presents the question whether the Federal Government may constitutionally impose

a tax upon the salary of the chief engineer of the Bureau of Water Supply of the City of New York.

Section 22 of the Revenue Act of 1928, *supra,* which applies in this case, imposes a tax upon the net income of every individual, which includes, among other items, all compensation received by the petitioner, unless, because of constitutional limitation, his compensation is immune from the taxing power of the Federal Government. *Helvering* v. *Powers,* 293 U. S. 214, 224.

The petitioner's sole contention is that his salary is immune because his services were rendered in connection with the exercise by the City of New York of a "usual governmental function." (Br. 9–10.) The contention, we submit, is without merit.

The rule of immunity, relied on by petitioner, is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system. The reasons underlying the principle mark the limits of its range. *Helvering* v. *Powers, supra,* pp. 224–225, 227; *Board of Trustees* v. *United States,* 289 U. S. 48, 59; *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 575, 576. Since the rule is aimed at the protection of the operations of government the immunity does not extend "to anything lying outside or beyond gov-

ernmental functions and their exertions." *Fox Film Corp.* v. *Doyal,* 286 U. S. 123, 128; *Board of Trustees* v. *United States, supra.* It is entirely clear that the operation by a municipality of a public utility such as a water works system is not a governmental function.

It is, of course, well recognized that a municipal corporation acts in a dual capacity. It exercises powers which are governmental and powers which are of a private or business character. In the one character a municipal corporation is a governmental subdivision of the State, and for that purpose exercises, by delegation, a part of the sovereignty of the State. In the other character it is a mere legal entity or juristic person. In the latter character it stands for the community in administration of local affairs wholly beyond the sphere of the public purposes for which its governmental powers are conferred. *Vilas* v. *Manila,* 220 U. S. 345, 356; *City of Winona* v. *Botzet,* 169 Fed. 321, 332 (C. C. A. 8th); *City of Galveston* v. *Rowan,* 20 F. (2d) 501, 502 (C. C. A. 5th).

It is well settled that in the maintenance of a water supply system, the municipality acts in a corporate or proprietary and not in a governmental capacity. McQuillin, *Municipal Corporations* (2d ed.), Secs. 1962, 2852; Borchard, Government Liability in Tort, 34 Yale Law Journal, 1, 252, 254. In fact, we have found no authority holding to the contrary. Some of the authorities,

classified according to States, are listed below.[1] This is the settled rule in New York, the highest court of that State holding that the very function here involved—the operation of the New York City water system—is a private and not a governmental function, and holding, moreover, in applying the doctrine of *respondeat superior,* that an employee of the city, engaged in such proprietary activity, is not an officer or employee of the State of New York, but an agent of the city performing services for the local advantage and benefit of the city and not for the State at large. *Bailey* v. *Major &c. of New York,* 3 Hill (N. Y.) 531, 538–539; *Oakes*

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[1] Connecticut: *Hourigan* v. *Norwich*, 77 Conn. 358, 365,

Georgia: *City Council of Augusta* v. *Mackey*, 113 Ga. 64, 68–69; *Huey* v. *Atlanta*, 8 Ga. App. 597, 599; *Carruthers* v. *City of Hawkinsville*, 42 Ga. App. 476.

Illinois: *City of Chicago* v. *Selz, Schwab & Co.*, 202 Ill. 545.

Indiana: *Aschoff* v. *City of Evansville*, 34 Ind. App. 25; *City of Huntingburg* v. *Morgen*, 90 Ind. App. 573.

Iowa: *Miller Groc. Co.* v. *City of Des Moines*, 195 Ia. 1310.

Massachusetts: *Lynch* v. *Springfield*, 174 Mass. 430; *Stoddard* v. *Winchester*, 157 Mass. 567,

Michigan: *Schenk* v. *City of Ann Arbor*, 196 Mich. 75, 91–92,

Minnesota: *Keever* v. *City of Mankato*, 113 Minn. 55, 61,

Missouri: *Dammann* v. *St. Louis*; 152 Mo. 186, 196; *Public Service Com.* v. *City of Kirkwood*, 319 Mo. 562, 567, citing *South Carolina* v. *United States*, 199 U. S. 437,

Montana: *Campbell* v. *City of Helena*, 92 Mont. 366; *Public Service Com.* v. *City of Helena*, 52 Mont. 527, 530,

New Hampshire: *Lockwood* v. *Dover*, 73 N. H. 209, 212,

North Carolina: *Munick* v. *Durham*, 181 N. C. 188, 195,

Mfg. Co. v. *City of New York*, 206 N. Y. 221, 228; *Canavan* v. *City of Mechanicville*, 229 N. Y. 473; *Matter of Water Comrs. of White Plains*, 176 N. Y. 239, 250–251; *Flatbush Waterworks Co.* v. *People*, 222 N. Y. S. 665; *Dunston* v. *City of New York*, 86 N. Y. S. 562, 566; *Messersmith* v. *City of Buffalo*, 122 N. Y. S. 918, 921–922.

In this view it is clear that there is in this case no immunity from Federal taxation because the taxpayer here is not an agent of the State of New

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Oklahoma: *Town of Hallett* v. *Stephens*, 125 Okla. 157, 160; *City of Oklahoma City* v. *Hoke*, 75 Okla. 211, 213,

Oregon: *Esberg Cigar Co.* v. *Portland*, 34 Ore. 282, 289–292; *Rice* v. *City of Portland*, 141 Ore. 205, 210,

Pennsylvania: *Armstrong & Latta* v. *Philadelphia*, 249 Pa. 39, 44; *City of Philadelphia* v. *Gilmartin*, 71 Pa. 140, 158,

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Wisconsin: *State Journal Printing Co.* v. *Madison*, 148 Wisc. 396, 403; *Piper* v. *Madison*, 140 Wisc. 311, 314–315,

United States: *City of Winona* v. *Botzet*, 169 Fed. 321 (C. C. A. 8th).

The English authorities regard cities in such matters as "substitutions, on a large scale, for individual enterprise." Mr. Justice Blackburn, in *Mersey Dock Trustees* v. *Gibbs*, 11 H. L. Cas., 686, at p. 706, approving Mr. Justice Mellor in *Coe* v. *Wise*, 5 B. & S. 440.

York engaged in a governmental function of the State or City of New York, but is an agent of the city engaged in a proprietary activity, acting for the peculiar local benefit of the city and not for the State at large. Since the rule of immunity is designed only to protect the States in the exercise of their governmental powers, it does not extend to the local and proprietary activity here in question.

Authoritative declarations by this Court confirm us in our position that the rule of immunity has no place in this proceeding. Thus, in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, this Court, speaking of the rule of immunity said (p. 172):

> It is no part of the essential governmental functions of a State to provide means of transportation, supply artificial light, *water* and the like. * * *
>
> The true distinction is between the attempted taxation of those operations of the States essential to the execution of its governmental functions and which the State can only do itself, and those activities which are of a private character. * * * [Italic supplied.]

In *South Carolina* v. *United States*, 199 U. S. 437, the Court said (pp. 461, 462):

> * * * the exemption of state agencies and instrumentalities from National taxation is limited to those which are of a strictly governmental character, and does not extend

> to those which are used by the State in the carrying on of an ordinary private business.
>
> * * * * *
>
> The supply of gaslight is no more a duty of sovereignty than the supply of water. Both these objects may be accomplished through the agency of individuals or private corporations, and in very many instances they are accomplished by those means. * * *

In *Helvering* v. *Powers,* 293 U. S. 214, the Court held that the operation of a similar public utility—the Boston Elevated Railway—was not a governmental function immune from Federal taxation.

And, in *Blair* v. *Byers,* 35 F. (2d) 326 (C. C. A. 8th), and again in *Denman* v. *Commissioner,* 73 F. (2d) 193 (C. C. A. 8th), it was likewise held that the operation of a water supply system was a proprietary rather than a governmental function and officers rendering services in that connection were not exempt from Federal taxation. A similar conclusion was reached by the court below. There are no decisions to the contrary. In view of this wealth of precedent we submit it is too late in the day now to urge a contrary view.

Other considerations compel a like conclusion. In determining whether a certain activity carries immunity from Federal taxation, we must always bear in mind the fundamental reason for denying Federal authority to tax. That reason, as this Court has often said, is found in the necessary protection of the independence of the respective gov-

ernments within their respective spheres under our Constitution. *Helvering* v. *Powers, supra; Collector* v. *Day,* 11 Wall. 113, 125, 127; *Ambrosini* v. *United States,* 187 U. S. 1, 7. These reasons outline the limits of the rule of immunity. *Board of Trustees* v. *United States,* 289 U. S. 48; *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 575, 576. Thus the principle of immunity has inherent limitations. *Helvering* v. *Powers, supra; Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 522–524; *Willcuts* v. *Bunn,* 282 U. S. 216, 225, 226; *Fox Film Corp.* v. *Doyal,* 286 U. S. 123, 128.

One of these limitations is that the rule be confined to the reasons that brought forth the rule; another is that the Federal taxing power is no less essential than the power reserved to the States, and, while preserving the latter, it is important not to cripple the former. Hence, the successful working of our dual governmental system requires that the principle of immunity be applied so as to interfere as little as possible with the important functions of Federal taxation, and, therefore, the rule is to be applied restrictively. *Willcuts* v. *Bunn,* 282 U. S. 216, 225; *Educational Films Corp.* v. *Ward,* 282 U. S. 379, 391. Accordingly, this Court has held that the necessary independence of the States requires that the rule be applied only to those functions "strictly" or "essentially" governmental in character. *South Carolina* v. *United States, supra,* p. 461; *Flint* v. *Stone Tracy Co., supra,* pp. 157,

172. Just what those functions are that are strictly and essentially governmental and necessary to preserve the separate independence of the States is difficult to state in terms of general application. See *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523.[2] Apparently, they include only the operations of the legislative, executive and judicial branches of state government in the making and enforcing of laws. See *Flint* v. *Stone Tracy Co., supra*, p. 157, 172; *Liggett & Myers Tobacco Co.* v. *United States*, 13 F. Supp. 143, 145, affirmed on other grounds, January 4, 1937, Nos. 161–163, October Term, 1936. It would seem that these are the only "strictly" governmental functions essen-

[2] The rule, as stated, is very general. That there is need for a more concrete formula, susceptible of application to particular cases is evidenced by the present doubt and confusion resulting from attempts to apply the rule. Cf. *Liggett & Myers Tobacco Co.* v. *United States*, 13 F. Supp. 143, 14 F. Supp. 543 (C. Cls.), affirmed on other grounds, January 4, 1937, Nos. 161–163, October Term, 1936; *Commissioner* v. *Ten Eyck*, 76 F. (2d) 515 (C. C. A. 2d); *Commissioner* v. *Sherman*, 69 F. (2d) 755 (C. C. A. 1st); *Halsey* v. *Helvering*, 75 F. (2d) 234 (App. D. C.); *Lyons* v. *Reinecke*, 10 F. (2d) 3 (C. C. A. 7th); *Hoskins* v. *Commissioner*, 84 F. (2d) 627 (C. C. A. 5th). In answer to this need the courts have attempted to lay down more definite formulae. Thus, it has been suggested that only those activities in which the States have "traditionally" engaged are immune. See *United States* v. *California*, 297 U. S. 175, 184–185. On the other hand, it is insisted that activities in which the States "usually" engage furnish the proper test. See *Commissioner* v. *Ten Eyck*, *supra*. Cf. *Helvering* v. *Powers*, *supra*. These tests will be considered below.

tial to the preservation of the States as independent governments—the only functions, which, as a sovereign power, the State itself only can do—the only functions necessary to preserve republican forms of government in the States, as guaranteed by the Constitution. But whether or not other state functions are included, it is clear that the operation by a municipality of a waterworks is not a strictly and essential governmental function necessary to the preservation of independent state governments. In fact, the State has no interest, governmental or otherwise, in the activity in question. In the case of *Bailey* v. *Mayor &c. of New York,* 3 Hill (N. Y.) 531, *supra,* in speaking of the New York City water supply, the court said (p. 539):

> *The state, in its sovereign character, has no interest in it.* * * * [Italics supplied.]

It cannot be said that that in which the State has no interest is essential to its corporate existence.

The rule of immunity has other limitations. It is not only to be strictly construed and confined to the reasons that gave it being—it is further limited by the settled principle that the States may not withdraw sources of revenue from the Federal taxing power by engaging in activities to which, by their nature, the Federal taxing power would normally extend. *Helvering* v. *Powers, supra; South Carolina* v. *United States,* 199 U. S. 437; *Murray* v. *Wilson Distilling Co.,* 213 U. S. 151, 173; *United States* v. *California,* 297 U. S. 175, 184–185; *Ohio* v. *Helvering,* 292 U. S. 360, 368, 369;

see also *United States Bank* v. *Planters' Bank*, 9 Wheat. 904, 907. It is clear that the activity in question falls within this limitation on the rule. In the purveying of water for a price the city is engaged in a profitable business enterprise.[3] It is engaged in an activity, which, at the time of the adoption of our Constitution, was carried on by private companies. (R. 15.)[4] It is engaged in an activity in which private corporations today

[3] Brief *amicus curiae*, by the State of New York, p. 29, states that the operations showed a deficit for 1932 and 1933, but whether this reflected the cost of supplying large quantities of water to the city for fire protection, street sprinkling and the like, aggregating approximately 25% of the total cost of operations (R. 15) does not appear; nor does it appear, nor has the Board found, that the enterprise has not proved profitable. The nature of the activity is such that it is capable of earning profit. The World Almanac for 1936 shows (p. 520) that the city, in 1934, got $35,781,458 from the sale of water. In 1925 it is reported that the net profit per annum, after providing for sinking fund, interest and other charges is $4,725,000. Thompson, *Public Ownership*, p. 218. A survey of the water supply of New York, published by the Merchants' Association of New York in August 1900, shows that "the waterworks of the former City of New York have been and are a source of profit and not a financial burden"; and that "The supplying of water to its citizens becomes an increasingly profitable enterprise." An Inquiry into the Conditions Relating to the Water Supply of the City of New York, pp. 5, 9–10.

[4] The Borough of Manhattan, constituting the old city of New York, had until 1842, no general water supply system. In 1833 the first legislation looking to such a system was enacted. See Legislation Relating to the Water Supply of the City of New York, December 1, 1928, published by the Board of Water Supply, City of New York, p. 1. See also Fairlie, *Municipal Administration* (1901), pp. 273, 275.

can and do perform. In fact, not only do private corporations supply water in other American cities, in New York City at the present time water is furnished and sold by private companies in certain areas. (R. 15.)[5] Some of these private companies are of substantial size. (R. 27.) In the Flatbush area alone some 240,000 persons are supplied with water by one of these private concerns. (R. 26.) See *Flatbush Waterworks Co.* v. *People,* 222 N. Y. S. 665 (1927). It is clear, then, that the city is engaged in a function to which the Federal taxing power would normally extend. The duties of the taxpayer as chief engineer of the New York Bureau of Water Supply are no different from those of similar engineers employed by private concerns engaged in a similar enterprise, and we submit that the city, in undertaking this enterprise, may not withdraw from the Federal taxing power sources of revenue that would otherwise come within it. We see no reason for putting the sale of water in a different category from the sale of liquor (*South Carolina* v. *United States,* 199 U. S. 437; *Ohio* v. *Helvering,* 292 U. S. 360) or from the operation of a street railway (*Helvering* v. *Powers,* 293 U. S. 214). And, if a State may not, by entering into these activities, thus withdraw sources of Federal

[5] The present water supply system of New York has been built up through the years not only by the construction of facilities by the city, but by the acquisition from time to time of private companies supplying certain areas. (R. 15.)

revenue, *a fortiori* a municipal corporation may not. The various contentions made by petitioner and in the several briefs *amici* have no merit.

1. The chief contention of petitioner, as well as of *amici* is predicated upon the premise that this Court in *Helvering* v. *Powers, supra,* has overruled its previous decisions in point and has established a new rule for determining immunity. This premise is false. The conclusion is, therefore, erroneous.

The premise is arrived at by lifting out of its context one phrase of the opinion in the *Powers* case—"usual governmental function." It is assumed that prior to the *Powers* decision the prevalent test for determining immunity was whether the activity was an "essential governmental function." This test, petitioner urges, was rejected in the *Powers* case, and there was substituted a new criterion of immunity—"usual governmental function." (Br. 10.) Petitioner then argues (Br. 14) that in defining "usual governmental function" the courts should not confine their attention to the situation prevailing when the Union was formed, but should look at current developments and expand the concept "usual governmental function" accordingly. The operation by a city of a system for supplying water to its inhabitants, the petitioner concludes, is today a "usual governmental function", for, he asserts, statistics show that it is practically an invariable thing for every city upon reaching

the 100,000 class, to shift from private to public ownership of waterworks, and that as of 1934, 80.39% of the waterworks in this country in cities of 10,000 or more were municipally owned and operated. (B. 13–14.)

Even if the petitioner were right in his assumption that the *Powers* case rejected previous tests and substituted therefor the "usual governmental function" test, it would avail him nothing. Even today, considering current developments, the operation of a municipal water supply is not considered in any jurisdiction that we know of as a "usual *governmental* function." The operation of a water works may be said to be not an unusual corporate activity, but it is not a usual *governmental* activity.

But the real answer is that the *Powers* decision did not change pre-existing rules. Not only did the Court rely with approval on all of the earlier leading decisions on the question, but it considered and applied the rules and limitations thereon as discussed above. This is clear when we consider the phrase "usual governmental function" in its context. In speaking of such functions as the sale of liquor and the operation of a street railway, the Court said (p. 227):

> In each case, the State, with its own conception of public advantage, is undertaking a business enterprise of a sort that is normally within the reach of the federal taxing power and is distinct from the usual governmental functions that are immune from federal tax-

> ation in order to safeguard the necessary independence of the State. * * *

It is not the frequency with which States engage in an activity but, as this Court held in the *Powers* case, it is the nature of that activity that furnishes the true test. Municipal corporations frequently, and in increasing numbers, own and operate street railways and other means of transportation. Such municipal activity is by no means "unusual",[6] yet under the very decision relied on by petitioner such activity is not beyond the reach of the Federal taxing power. Similarly, States today in increasing numbers are engaging in the sale and distribution of liquor. State liquor stores are today by no means "unusual",[7] yet *Ohio* v. *Helvering,* 292 U. S. 360, approved in the *Powers* case, holds that such activity is not outside the sphere of Federal taxation. Ineed, in the Ohio case the State's argument was very similar to the argument made here (see briefs in that case, pp. 17, 18, 20, 33), but the Court rejected the contention by saying, p. 369 of 292 U. S.:

> The argument seems to be that the police power is elastic and capable of development

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[6] It is reported that in 1925, 32 cities in the United States and Canada owned and operated municipal railways of which 15 were in the States. Thompson, *Public Ownership,* p. 224. Undoubtedly, the number has increased in the past eleven years.

[7] According to the World Almanac for 1936, p. 189, fifteen States have set up state monopolies for the sale of liquor.

> and change to meet changing conditions. Nevertheless, the police power is and remains a governmental power, and applied to business activities is the power to regulate those activities, not to engage in carrying them on. * * *

This growing movement toward municipal ownership of public utilities is noticeable in many fields. Cities have constantly been extending their fields of endeavor and now maintain and operate waterworks, light and power plants, street railways, bus lines and other transportation systems, gas plants, grain elevators, wood and fuel yards and other merchandising enterprises, public docks, wharves, markets, and the like. This Court noticed the trend in *South Carolina* v. *United States, supra,* and commented thereon at length, see pp. 454–455 of 199 U. S. See also *Fawcett* v. *Mt. Airy,* 134 N. C. 125. The courts accord the local governments the broadest latitude in this direction.[8] As these permissible activities multiply, so the need for the protection of Federal revenues grows. That need is greater today than ever before.[9] It is in answer to this need

[8] As indicating the extent to which the courts permit local governments to go in the ownership of public utilities and other business affected with a public interest see *Green* v. *Frazier*, 253 U. S. 233; *Jones* v. *Portland*, 245 U. S. 217; *Sun Publishing Assn.* v. *Mayor*, 152 N. Y. 257; Pond, *Municipal Control of Public Utilities*, p. 15 *et seq.*

[9] The loss in Federal revenues through the operations of the rule of immunity is great. Accurate figures are not available but the following statistics are of interest. Approxi-

that the courts have repeatedly held that immunity does not extend to non-governmental activities of this sort, and ever since the decision in *South Carolina* v. *United States, supra,* the philosophy of the decisions has been, not to liberalize the rule as argued by petitioner, but to restrict and narrow it in the interest of the Federal revenues. Cf. *Willcuts* v. *Bunn,* 282 U. S. 216, 225–226; *Fox Film Corp.* v. *Doyal,* 286 U. S. 123; *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514; *Group No. 1 Oil Corp.* v. *Bass,* 283 U. S. 279; *Burnet* v. *Coronado Oil & Gas Co.,* 285 U. S. 393; *Burnet* v. *A. T. Jergins Trust,* 288 U. S. 508; *Ohio* v. *Helvering, supra.* Accordingly, the frequency with which cities own and operate water works, far from being an argument in favor of immunity, only demonstrates the need for applying the "inherent limitations" on the rule. Cf. *Helvering* v. *Powers, supra.*

2. Although petitioner does not make the point, the several briefs *amici* assert that in early colonial days in New York, and at the time of the adoption of the Federal Constitution, the Borough of Manhattan owned and controlled certain public wells

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mately 4,891,000 persons were employed in 1935 by the several States and municipalities. Only 4,300,691 income tax returns were filed with the Federal Government for that year, of which only 1,836,165 were taxable and 2,464,526 were non-taxable. Moreover, whereas 5.20% of the total population filed taxable returns for 1920, only 1.43% filed such returns for 1935. See Brabson, *Income Tax Exemptions and the Loss of Federal Revenues,* Income Tax Magazine, January 1937, p. 8.

from which its inhabitants could obtain water. Thus, they argue, traditionally the supplying of water to its citizens is a function of New York City government, and they invoke to their aid the decision of this Court in *United States* v. *California*, 297 U. S. 175, where, in speaking of the rule of immunity, the Court said (pp. 184–185):

> Its nature requires that it be so construed as to allow to each government reasonable scope for its taxing power, see *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 522–524, which would be unduly curtailed if either by extending its activities could withdraw from the taxing power of the other subjects of taxation *traditionally* within it. *Helvering* v. *Powers*, 293 U. S. 214, 225; *Ohio* v. *Helvering*, 292 U. S. 360; *South Carolina* v. *United States*, 199 U. S. 437; see *Murray* v. *Wilson Distilling Co.*, 213 U. S. 151, 173, explaining *South Carolina* v. *United States, supra.* Hence we look to the activities in which the states have *traditionally* engaged as marking the boundary of the restriction upon the federal taxing power. * * * [Italics supplied.]

As we read the foregoing statement, this Court was not establishing a new rule of immunity; it was merely restating one of the limitations on the rule heretofore discussed, that States may not by entering into new fields of endeavor, withdraw from the Federal taxing power sources of revenue that would normally be within it. As we have shown above, in engaging in the sale of water for profit the

city is seeking to do that very thing. The fact that in colonial times there were in New York City certain publicly owned wells from which people could obtain water, falls far short of showing that the sale of water for a profit was, in 1789, or at any other time, a generally recognized function of *state* government. For a number of years municipal corporations have undertaken to supply water to its inhabitants, but at no time, as the many cases cited above show, has this activity been deemed a state function. It is, and always has been, recognized as a private function of the city's, carried on for its own profit and for the advantage of the local inhabitants, and not for the State at large. The State, as a state government, is not concerned. Traditionally, the States have not engaged in the sale of water.

Moreover, the sale of water is not, traditionally, even a municipal function. There is a distinction in the nature of the activity (cf. *Helvering* v. *Powers, supra*) between the digging of a few wells to which the inhabitants may themselves go for water, and the conduct of the business of selling water for profit. In fact, the interesting historical summary contained in the briefs *amici* does not even show that public wells were prevalent throughout the colonies. The Board of Tax Appeals has found in the present case that in the early days of New York City water was furnished its citizens by private companies, and that in certain

areas water is furnished and sold by private companies at the present time. (R. 15.) And it is stated to be an historical fact that the movement toward extensive waterworks and municipal undertakings did not begin in the United States until the second third of the nineteenth century. Even as late as 1835, Philadelphia was the only important city with a municipal supply. And it was not until about this time that the City of New York began the construction of the Croton reservoir and aqueduct, which was the first large modern system of water supply. Approximately at the same time the movement toward municipal waterworks became noticeable in Great Britain. As late as 1900, however, in England, the water supply of London, Bristol, and five other towns of over 100,000 population was not under municipal control. And as of that time the cities of San Francisco, New Orleans, New Haven, Paterson, St. Joseph, Omaha, Los Angeles, Memphis, and Scranton, each over 100,000 population, were supplied with water by private concerns. Fairlie, *Municipal Administration* (1901), pp. 273, 275; see also Thompson, *Public Ownership* (1925), 204–206; *Fawcett* v. *Mt. Airy*, 134 N. C. 125. Thus, traditionally, the business of selling water is neither a state nor a municipal activity.

3. Petitioner, recognizing that the state cases, including those of New York, are uniformly against him in holding that the operation of a

water supply is a proprietary and not a governmental function, seeks to avoid the force of those decisions on the ground that those cases involve municipal liability in tort actions and have no bearing on the law of taxation or the determination of constitutional immunity. It is perhaps enough to say that those cases do present persuasive analogy and this Court has resorted to such cases in determining the question of immunity from taxation. See e. g., *South Carolina* v. *United States,* 199 U. S. 437, 463. Under the local law, the activity in question is not deemed to be a governmental activity; the taxpayer here is not deemed to be a state officer; and the State, as such, is not concerned with his duties. It should follow automatically that his employment is not so essential to the preservation of the New York State government as to render his salary immune from Federal taxation.

However, we are inclined to agree with petitioner that the rule of immunity from taxation is not at all times the same as the rule of immunity from suit in tort cases. We believe the rule of immunity in taxation is even narrower and more strict than is the rule of immunity from suit. This is evidenced not only by the statements of this Court that immunity from taxation extends only to those functions which are "essentially" or "strictly" governmental (*South Carolina* v. *United States, supra; Flint* v. *Stone Tracy Co.,*

supra), but it is shown, further, by the well-established limitations on the rule of immunity in taxation, discussed above—limitations not affecting the rule of immunity from suit in tort cases. Moreover, there may be instances in which a State as a sovereign may be free from suit, and yet at the same time not immune from Federal taxation, as, for example, in the operation of a state-owned liquor store or in the operation of a state-owned railroad. Cf. *South Carolina* v. *United States, supra; Ohio* v. *Helvering, supra; Helvering* v. *Powers, supra.* Thus, the rule of immunity with which we are here concerned is even narrower and more strict than is the rule in the tort cases referred to, and those cases, therefore, apply *a fortiori* here.[10]

4. Brief *amicus curiae* on behalf of the City of New York (p. 18) states that it is common knowledge that there is often a direct connection between the water supply and the transmission of certain communicable diseases, and urges that the protection of the public health in large cities dictates the

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[10] The distinction is unimportant in this case, but it may become important in considering certain other municipal functions, such as the maintenance of city streets, parks, sewerage and garbage disposal systems and the like, where the state courts are very nearly evenly divided on the question of whether they are governmental or proprietary. The need for a uniform rule in taxation in such cases is evident, and in such instances, we believe immunity should not be extended even in those States where the municipality is granted immunity from suit.

government operation of the water supply system. The answer is found in *Ohio* v. *Helvering,* 292 U. S. 360, 369, where a similar argument was made—"the police power is and remains a governmental power, and applied to business activities is the power to regulate those activities, not to engage in carrying them on." Moreover, the argument proves too much. Milk, likewise is a transmitter of diseases and as a necessary item in the human diet its distribution is affected with a public interest. Cf. *Nebbia* v. *New York,* 291 U. S. 502. Pure food is likewise essential to the public health, as is also proper clothing, yet, as the court below pointedly observed (R. 47) no one would undertake to maintain that if the city should decide to supply such necessities it would be engaging in an activity necessary to its existence as a government. There are today in New York City private companies supplying water to New York citizens. (R. 15.) The protection of the public health has not dictated the municipal ownership of these.

5. In the court below and in his petition for certiorari in this Court, petitioner contended that the supplying of water in the City of New York was an activity which the city alone could perform because of the magnitude of the task, and, therefore, the activity was a governmental as opposed to a proprietary function. (Br. in support of Pet., pp. 11–13.) He does not make this contention in his brief on the merits, and we assume he has aban-

doned the point. In any event, as the court below pointed out (R. 46), there is no support for the argument in the record. It does not appear that private enterprise adequately encouraged could not perform the task, and to say that it could not in the light of modern private achievement in business on a vast scale, as, for example, the operations of the Pennsylvania Railroad, and the American Telephone and Telegraph Company, would seem to deny probability.

6. In his petition for certiorari, the petitioner urged that the present case is in conflict with *Halsey* v. *Helvering*, 75 F. (2d) 234 (App. D. C.). He does not rely on that case in his brief on the merits. In any event, we do not believe that that case is opposed to our contention here. There, the taxpayer was the city engineer of two New Jersey municipalities, and his duties consisted of advising the municipalities on *all* engineering matters, which specifically included construction, maintenance, and alteration of streets and ways, sewers, waterworks, and lighting systems; the preparation of plans and specifications, and maintaining custody of the same. While advice and preparation of plans in connection with waterworks were among his duties, the taxpayer's employment was in connection with all engineering matters of the towns and his services were rendered only in furnishing the town authorities with information upon which they could act. His services were not rendered

solely in connection with the operation of the water-works system.

7. *Ashton* v. *Cameron County Dist.*, 298 U. S. 513, relied on heavily by petitioner, is readily distinguishable. There the Court merely said, by way of reasoning, that Congress may not tax the bonds issued by a State or political subdivision thereof. "So to do would be an unwarranted interference with fiscal matters of the State—*essentials to her existence.*" (P. 529.) [Italics supplied.] The Court further said that the Cameron County Water Improvement District, created under the laws of Texas, and being vested with certain sovereign powers, including the power of taxation, was a political subdivision of the State, but the Court did not hold that every function to be performed by such political subdivision, or, more particularly, the selling of water to the inhabitants of the political subdivision, was a function of government, essential to the existence of the State as an independent government. *Ohio* v. *Helvering, supra; South Carolina* v. *United States, supra; Helvering* v. *Powers, supra,* at p. 227, and *Flint* v. *Stone Tracy Co., supra,* are to the contrary, and there is no intimation in the *Cameron* decision that the principles established in those cases were intended to be modified in any respect.

8. Reliance is also placed on *Columbus* v. *Mercantile Trust Co.*, 218 U. S. 645, from which the petitioner quotes the statement that "no higher

police duty rests upon municipal authority than that of furnishing an ample supply of pure and wholesome water for public and domestic uses." (P. 658.) That case did not touch on the question here presented. It involved the right of a municipality to construct and operate a waterworks system, when a private concern failed to supply water according to its franchise. *Flint* v. *Stone Tracy Co.*, *supra*, involving the question of immunity, was decided only three months later, wherein it was said (p. 172) that it was no part of the essential governmental function of a State to supply water. If effect be given to the statements in both cases, the conclusion follows that even though a particular activity be a police duty, it is not by reason of that fact an essential governmental function.

Other cases relied on by petitioner were concerned with utterly different state functions and are, therefore, distinguishable on their facts.

9. Finally, petitioner contends (Br. 16–17) that sources of Federal revenues are not affected by the activity in question, because for a century no attempt has been made to tax the salaries of water works employees. It is true that under the War Revenue Act of 1917, Section 201 (a) (c. 63, 40 Stat. 300, 303), Congress did not exercise its taxing power to the fullest, and specifically excepted from the Act compensation of officers and employees of States and their local subdivisions, whether or not they were engaged in essential governmental func-

tions. The exemption was removed in the Revenue Act of 1918 (c. 18, 40 Stat. 1057), but inequalities in administration caused Congress, in Section 1211 of the Revenue Act of 1926 (c. 27, 44 Stat. 9), to refund or abate all such taxes imposed by the 1924 and prior revenue Acts. However, since January 1, 1925, the salaries of employees of municipal waterworks have been taxable. See report of the Hearings before the Committee of the House of Representatives on Revenue Revision, 1925, pp. 196–197; Congressional Record, 69th Congress, 1st Sess., Vol. 67, pp. 2955, 2956; Mim. 3838, IX–2 Cumulative Bulletin 137, 140. We submit that to extend immunity to the salary in question would be to withdraw sources of revenue normally within the Federal taxing power. *Helvering* v. *Powers*, *supra*.

CONCLUSION

The decision below should be affirmed.

Respectfully submitted.

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